

USAID POLICY PAPER

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PROGRAM ASSISTANCE

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PROGRAM ASSISTANCE

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PROGRAM ASSISTANCE¹

1 INTRODUCTION

1.1 GENERAL DESCRIPTION

The distinguishing feature of program assistance is the manner in which USAID resources are provided. Under this mode, USAID provides a generalized resource transfer, in the form of foreign exchange or commodities, to the recipient government. This is in contrast to other types of assistance in which USAID finances specific inputs, such as technical assistance, training, equipment, vehicles, capital, construction, etc. (This distinction parallels the distinction in law and previous USAID usage between project and non-project assistance.)

This category of assistance includes two sub-types: sector program assistance (SPA), and balance of payments and budget support (BPB). Whereas these sub-types share some common elements (e.g., resource transfer mechanisms, local currency requirements), they differ in focus and objectives. SPA promotes medium- to long-term increases in production or efficiency in a specific economic sector or sectors. Such assistance is directly linked to specific policy, institutional, or other host country actions necessary to further agreed-upon development objectives at the sectoral level. In some limited cases permitted by law, BPB may be primarily concerned with promoting economic and political stability by bridging a public sector budget and/or balance of payments shortfall. This may be accompanied in appropriate cases by policy reforms also supported by the program. The time horizon for BPB, therefore, may be short-, medium-, or long-term. The unique attributes and requirements of SPA are highlighted in section 2, and those for BPB support are contained in section 3. Either one of these sections must be read in conjunction with section 4, which describes the common elements and requirements of SPA and BPB support.

1.2 DEFINITIONS

1.21 General Program Terms

Cash Disbursement: Method for rapidly disbursing dollar assistance by USAID to a host government. One of the major disbursement instruments used in program assistance.

¹Supersedes former Handbook 4 of September 1975 as revised and amended.

Commodity Import Program (CIP): Method by which USAID finances the foreign exchange costs of procuring and shipping eligible commodities on a generalized, sector, target group, or product basis. It is one of the major disbursement instruments used in program assistance.

Conditionality: stipulated requirements which must be met by the recipient of USAID assistance prior to the disbursement of designated funds.

Disbursement Tranching: Generally preferred form of providing medium-to-long term program assistance when conditions are to be met in stages over an extended period of time. It allows funds to be disbursed periodically in accordance with progress on pre-established conditions.

Sector: a set of economic activities unified by a common output narrow enough to have an analytical identity and broad enough to encompass significant investment and policy issues. In sector program assistance, this term can refer to a broad area such as agriculture, industry, education, health, exports; or, it can refer to a sub-sector such as agricultural marketing, health care financing, child survival.

USAID assistance may address more than one sector at a time. Such multisector assistance is concerned with economic policy reforms that directly affect sustainable development and beneficiaries in more than one sector of the host country at a time. Examples of multisector policy reforms include budget and tax code reforms, reductions in trade and exchange rate restrictions, improved monetary policies, widening and deepening of financial markets, privatization, improved labor laws and policies, improved land tenure arrangements, and enhanced property rights, including intellectual property rights and patents, contract and property law, and business regulations.

Separate Dollar Account: Dedicated host country-owned bank account into which USAID deposits dollars when providing assistance through cash disbursement procedures.

1.22 Local Currency Terms

Host-Country-Owned Local Currency (HCOLC): Program assistance provide a resource transfer from the U.S. Government to the host government. This transfer increases the import capacity of the country in general, and, because the grant is made to the government, the government's claim on resources in particular.

It is common to separate these two aspects of the transfer, the foreign exchange and the fiscal, through a commercial sale of foreign exchange or commodities. The proceeds of the foreign exchange or commodity sale, which represent a claim on domestic resources, analogous to a tax receipt, are usually segregated in a separate account, rather than being generally available to the host government. These proceeds are then jointly programmed by the host government and USAID.

Local currency can be "generated" in two ways: First, through the sale of foreign exchange, CIP commodities, or PL 480 commodities to the public. Second, in some cash disbursements, the banking transaction which effects the transfer increases the foreign assets of the banking system and simultaneously creates a banking system liability owned by the government. This liability can be in the form of HCOLC.

In some resource transfers, the assistance is used to meet foreign currency requirements of the government itself (e.g., repayment of host country external debt; public sector CIPs). In these cases, the transaction encompasses both the foreign exchange and the fiscal aspects of the resource transfer and there is no further local currency to be utilized. In such circumstances, it is nevertheless still possible to create HCOLC through program "conditionality" that requires the host government to "set aside" local currency through a deposit into a separate account from its own budgetary resources.

Local Currency Special Account: A distinct, dedicated account into which HCOLC is deposited to prevent commingling. Funds from the account are used for purposes jointly agreed upon by USAID and the host country.

General Budget Support: One of several end uses for HCOLC; the term used when HCOLC disbursements are made into a general budgetary account of the host government.

Sectoral Budget Support: One of several end uses for HCOLC; the term used when HCOLC is disbursed into the account of a specific Ministry or other host government agency in support of sectoral development objectives.

"Projectized" Local Currency: One of several end uses for HCOLC; the term used when HCOLC disbursements are made in support of a specific activity or project of the host country, USAID, or an International Financial Institution. This end use has special accounting requirements to demonstrate how money was spent.

Trust Funds: When appropriate and fully justified, HCOLC is sometimes placed "in trust" with USAID to manage. There are both program and operating expense (OE) trust funds. A trust arrangement must be formalized with the host government and recorded in a Trust Fund Agreement. The United States Disbursing Officer (USDO) controls the deposit of funds into the special trust fund account, and USAID is ultimately responsible for managing the actual uses of funds held in trust. (See Supplementary References, Bulletin No. 5 - Local Currency Trust Funds, for guidance in setting up trust funds with host country owned local currency.)

2 SECTOR PROGRAM ASSISTANCE (SPA)

2.1 DESCRIPTION AND OBJECTIVES

Sector program assistance is the provision of generalized resources to assist host governments in achieving agreed-upon sectoral goals and objectives. This type of assistance focusses on sector constraints to sustainable growth and facilitates the implementation of reforms and other actions to alleviate those constraints and attain measurable development results. The disbursement of USAID resources is always linked to the successful fulfillment of conditionality, previously agreed to by USAID and the host government.

Sector program assistance recognizes that policy reforms have costs as well as benefits and that the costs, although usually much smaller than the benefits, are concentrated and immediate, while the benefits can be diffuse and longer term. Sector assistance enables the government to offset the short-term costs of sectoral policy reform.

Although the centerpiece of sector program assistance is a generalized resource transfer, through a CIP or cash disbursement, it often includes more traditional inputs such as technical assistance and training, when such elements are deemed essential to achieving the objectives of the sector reform program. In general, sector program assistance relies on host government agencies for implementation.

Any type of funding may be used for sector program assistance (e.g., development assistance (DA), DFA, ESF, SEED ACT, FREEDOM Support Act, PL 480 etc.) as authorized by the underlying legislation.

2.2 CONSIDERATIONS DURING STRATEGIC PLANNING AND RESOURCE ALLOCATION EXERCISES

2.21 Sector Assessments

This type of assistance represents a major investment of USAID resources in one sector of the host country. Therefore, the target sector must be thoroughly analyzed. A separate sector assessment is not necessary if a full analysis was recently completed. Similarly, a separate assessment is not always needed in countries where the USAID operating unit has a long history of involvement in the sector and adequate data and information exist to identify significant problems and accurately design the assistance activity.

2.22

Appropriateness

Three important issues must be addressed when considering this type of assistance.

(a) Relationship to strategy: the operating unit must have a clear rationale for choosing the target sector, demonstrating the importance of the sector (or sub-sector) to the overall development of the host country and to the strategic plan of the USAID.

(b) Constraints to growth: the operating unit must have a clear understanding of the specific problems which impede growth or efficiency in the target sector and how those problems can best be alleviated. The operating unit must decide whether the constraints critical to progress within the sector are best addressed through the financing of specific inputs by USAID, whether it is more effective to tie the transfer of USAID resources to the implementation of specific policy reform actions taken by the host government in the target sector, or whether some combination of the two approaches is most appropriate.

Policy and institutional reforms can be addressed through a variety of approaches. Promoting a policy dialogue agenda is a common approach, as is the use of "conditions precedent to disbursement," when particular government actions are needed for a successful program. Concomitantly, a well-defined input, such as technical assistance, is often an important factor for stimulating reform.

An array of factors must be examined in making a decision on the best assistance mode, including: (i) the macroeconomic, policy and political conditions of the country; (ii) host country commitment and implementation capacity in the sector; (iii) the level of effort required to develop, agree upon and implement a policy and institutional reform agenda; (iv) the level of resources available; and (v) a determination of what is truly needed to alleviate constraints and effect reform in the sector in question.

(c) Ownership of the development agenda: the operating unit must have a clear understanding of the source and driving force behind the development agenda in a particular sector. The more the specific objectives of the assistance and the changes needed to reach those objectives, including difficult and complex policy reforms, are identified by the host country entities responsible for implementing them, the more appropriate is a generalized resource transfer. Cash disbursement

programs are sometimes criticized because they are seen as "forced upon" cash-starved governments; or donor agencies are accused of "buying policy reform." This must not be the case in choosing sector program assistance as a primary assistance mode.

- 2.23 USAID Management Capability
Experience has demonstrated that sector program assistance is management intensive. The activities for which managers are responsible can be very wide ranging - from policy dialogue, to general programming of financial resources, to end-use monitoring of commodities. Operating units need to assess the management implications of implementing sector program assistance prior to design to ensure that the appropriate skills and numbers of USAID personnel are available.
- 2.24 Coordination with Other Donors
Understanding what other donors are doing in the target sector is essential at the assistance identification stage, as well as during planning and implementation of the activity. Operating units must determine whether other donor activity is consistent with the policy reforms being supported by USAID and to what extent the results being sought by the USAID program may be influenced by other donor efforts.
- 2.3 SPECIAL PLANNING REQUIREMENTS
- 2.31 Resource Transfer Mechanisms
Early in the planning process, the operating unit must choose the type of resource transfer mechanism it intends to use to deliver the proposed assistance. This choice is normally made between a Commodity Import Program (CIP) or a cash disbursement. The mechanism chosen will, in turn, influence aspects of the planning process. See section 4.31 for guidelines.
- 2.32 Defining Impact
Sector program assistance shall be used to support sectoral development objectives that can ultimately be defined in terms of their impacts on people or households (e.g., increased income, production, employment; improved health care; increased access to education; etc.) or on the natural environment (e.g., preservation of biodiversity). The purpose of a sector program assistance activity shall be described by variables which are quantitatively or qualitatively measurable. The keys to planning and justifying sector program assistance are an adequate data base to define and analyze the proposed assistance, the development of

effective conditionality, and the development of indicators for measuring performance and impact.

2.33

Analyses

Rigorous analysis is crucial to a successful sector program assistance effort. Planners must be concerned with cost/benefit, feasibility, and sustainability questions from six analytical perspectives:

(i) social/vulnerability, which assesses the impact of the program on affected groups, including those who benefit and those who might be adversely affected, indicating, for the latter group, what "safety net" mechanism(s) might be needed to mitigate the program's adverse impact. Affected groups shall be appropriately disaggregated to the extent practicable, including disaggregation by gender;

(ii) institutional, which frankly examines the capacity within the host government and other involved organizations to develop, agree upon, and implement all aspects of the assistance (including sectoral reform measures, commodity imports or cash disbursements, programming and accounting for HCOLC, etc.);

(iii) political, which gauges the will of the government to undertake the proposed reform and the populace to accept the impact of the reforms; includes assessment of political costs, and extent of public information and debate;

(iv) legal, which identifies any legal constraints to the proposed policy or institutional reforms, and assesses the potential for accomplishing any legislative changes required to enact reforms in a timely manner;

(v) financial, which evaluates whether available financing (local, USAID, other donor) is sufficient to cover the costs of the reform in terms of implementation expenditures, compensation for sector adjustments, and expenses for any social safety-net mechanisms which might be required;

(vi) economic, which analyzes the supporting macroeconomic framework, the economic costs and benefits of the proposed reforms, and the projected time frame in which benefits outweigh costs.

Planners must have a clear understanding of (i) the rationale for their design choices, and (ii) any risks associated with the activity either in terms of

implementation or sustainable development impact. Moreover, in carrying out the various recommended analyses, planners shall, where practicable, identify ultimate beneficiaries and consult them through survey or other instruments in order to properly assess beneficiary needs and attitudes regarding the contemplated assistance.

2.34 Quantifying the USAID Contribution

Unlike input-financing, the amount of resources required for a generalized resource transfer are much harder to calculate. Instead of estimating costs based on a predetermined level of effort, the USAID contribution is based on (i) available resource levels; and (ii) an understanding of the costs associated with sector policy reforms and resulting changes in the sector.

In assessing the costs and benefits of the proposed reform agenda, consideration must be given as to how government revenues will be affected by implementing the proposed reform program, either in terms of reduced income flows or increased fiscal outlays. Ultimately, the operating unit must ask what amount of resources will make it possible and worthwhile for the host country to incur all of the costs attendant to the reform agenda.

2.35 Traditional Inputs

When a proposal for sector program assistance includes traditional inputs such as technical assistance (TA) or training, appropriate management plans (e.g., financial, procurement, monitoring) shall be prepared to cover these inputs. Technical assistance can be an important element in successful implementation of sector program assistance. At the same time, excessive requirements for technical assistance, particularly for long-term, residential advisors, can sometimes suggest weaknesses in the design of the sector program assistance proposal (e.g., that more capacity building is necessary for the host country to assume leadership of the program, that analytical work was not satisfactorily completed, or that the operating unit is unwilling to assume the risks associated with sector program assistance).

2.36 Local Currency Use

Section 4.4 describes requirements related to local currency. In sector program assistance, the anticipated uses of local currency must assist in attaining the proposed development objectives, at the

sectoral level, in an identifiable and measurable way.

2.37 Implementation Planning

The duration of a sector program assistance activity extends beyond the generalized resource transfer. Implementation plans must be based on tracking progress to the strategic objective level.

Four types of plans are recommended for implementing and monitoring sector program assistance: (i) implementation plan, which describes specific accomplishments to be achieved at specific times, the tranching of USAID disbursements against program accomplishments, and the respective roles of USAID and the host government; (ii) performance measurement plan, which outlines how the operating unit will monitor conditions to disbursement and assess progress toward higher level performance indicators, including the anticipated costs of these investigations; (iii) resource tracking plan, which describes the use and accountability arrangements agreed to for the resources made available (dollars or commodities) by the USAID contribution; (iv) local currency use plan, which details proposed uses, allocation levels, oversight and monitoring mechanisms for the local currency made available by the sector program assistance activity.

2.38 Review and Approval

Because of the size of resources normally involved, as well as the policy implications of sector program assistance, the cognizant operating bureau may request information on contemplated sector program assistance activities at the time that Strategic Plan or Results Review and Resource Request documents are reviewed by USAID/W. Where applicable, this request will be communicated to the field operating unit at the time parameters are established for these documents.

2.4 SPECIAL MANAGEMENT REQUIREMENTS

2.41 Implementation

Because resources are tied to the progressive completion of planned reforms under this type of assistance, implementation actions are expected to be initiated by the host government, not USAID. Management systems need to be in place between the USAID operating unit and the host government, for: (i) reaching agreement on specific performance steps; (ii) recording agreement on satisfaction of conditions precedent, specific programming of local currency, etc.; (iii) managing and accounting for USAID

resources; and (iv) collecting and monitoring data, and assessing development impact.

2.42

Reporting

In general, quarterly reports from the recipient government are recommended on all aspects of the program managed by the recipient government (conditionality, dollar tracking, HCOLC deposits, disbursements and uses, etc.). It is incumbent upon the operating unit to verify, at least annually, the accuracy of host government reports.

2.43

Performance Measurement

Operating units are expected to work collaboratively with the host country in planning and measuring the tangible results of the USAID assistance. In sector program assistance there is an increased reliance on the host government for accurate data and information. Therefore, the USAID line manager must ensure that host country institutions are providing adequate information for measuring and assessing program impact. (See Series 200, Chapter 203, Monitoring and Evaluating Performance, for guidelines on monitoring indicators and assessing impact.)

3 BALANCE OF PAYMENTS AND BUDGET (BPB) SUPPORT

3.1 AUTHORITY

Part II, Chapter 4 of the Foreign Assistance Act of 1961, as amended (FAA), establishes the Economic Support Fund (ESF), which may be used among other things for cash or CIP assistance specifically to promote economic or political stability. Under the statutory authority for ESF, such assistance should, however, be provided to the maximum extent feasible in a manner consistent with the development purposes of Part I of the FAA.

Sections 2 and 3 of the Support for East European Democracy (SEED) Act of 1989, (1) define the objectives of the Act as contributing to the development of democratic institutions, political pluralism, and the promotion of free market economic systems, (2) contain an illustrative list of actions that can be taken to achieve those objectives, and (3) authorize the use of SEED Act authorities to conduct assistance activities in any East European country similar to those conducted in Poland except for the stabilization program described in section 102 of that Act. Funds for assistance for East and Central European countries are appropriated under the heading in the annual foreign assistance appropriations act -entitled "Assistance for Eastern Europe and the Baltic States" and are made available to carry out the provisions of the Foreign Assistance Act as well as the SEED Act. Such language is broad enough to encompass the kinds of programs discussed in this chapter.

Section 498 of the Foreign Assistance Act provides the basic authorization for assistance for the former Soviet Union. Assistance is authorized to the independent states of the former Soviet Union for specified activities including, among others, meeting urgent humanitarian needs, creating and developing private enterprise and free market systems, and creating conditions that promote trade and investment. Given the relative specificity of this authorization, it will be harder to justify balance of payments program assistance under this authority. Recent correspondence between the Secretary of State and the Congress recognizes the latter's skepticism of using FREEDOM Support Act funds for this purpose.

3.2 DESCRIPTION AND OBJECTIVES

Balance of Payments and Budget (BPB) support provides a generalized resource transfer to the recipient country. In limited cases authorized by law, it is designed to

support short- and medium-term economic or political stabilization through measures which address immediate gaps in the country's balance of payments or budget.

3.3 CONSIDERATIONS DURING STRATEGIC PLANNING AND RESOURCE ALLOCATION EXERCISES

3.31 Appropriateness

This type of assistance can help the recipient country bridge a public sector budget and/or balance of payments shortfall which can be mitigated in appropriate cases by policy reforms adopted through the program. The assistance provides an immediate strengthening of the country's international reserve position.

Filling a balance of payments or budget shortfall makes best sense when the rationale is political, or when such shortfalls are temporary, with policy reform efforts used to close such gaps over time where appropriate. In this latter context, the resource transfer mitigates the possible short-term drop in consumption and production that sometimes occurs as policy reforms are adopted.

Experience has shown that balance of payments or budget assistance on a prolonged basis is not desirable where the policy and institutional environments of the recipient country are inadequate to permit reasonably effective use of the resources. In such cases, priority must be given to economic policy reform and restructuring of the national economy. Familiarity with the political, economic and social conditions of the country is essential in determining whether the government will be receptive to the type of conditionality implicit in policy reform and economic restructuring.

3.32 USAID Management Capability

BPB support can be management intensive if policy reforms and economic changes are also being pursued. This is particularly true if the assistance is intended to include a commodity import component, and local currency programming and monitoring (see 4.3). Operational units need to assess the management implications of implementing BPB support at the resource allocation stage to ensure the appropriate skills and numbers of personnel will be available to manage the effort.

- 3.33 Coordination with Other Donors
Coordinating the development of a BPB support program with other bilateral and multilateral donors is intended to maximize complementarity in programs and to avoid conflicting or duplicative efforts by the donor community. USAID-financed assistance frequently reinforces the objectives of World Bank and/or IMF policy reform programs executed with the recipient country for these reasons.
- 3.4 Special Planning Requirements
- 3.41 Resource Transfer Mechanisms
Early in the planning process, the operational unit must choose the type of resource transfer mechanism it intends to use to deliver the proposed assistance. This choice is between a Commodity Import Program (CIP) and a cash disbursement. The mechanism chosen will, in turn, influence aspects of the planning process. See section 4.31 for guidelines.
- 3.42 Defining Impact
Although the objectives, conditions, and performance indicators of BPB support are often at broad levels, it is expected that those proposals which also focus on policy reform will indicate how the proposed changes will impact on people in the recipient country. These expected medium- to long-term effects shall include quantitative or qualitative indicators which can be monitored for evaluation purposes (see section 3.52 as well as Series 200, Chapter 203, Monitoring and Evaluating Performance).
- 3.43 Analyses
Rigorous analyses are required, particularly when the BPB support program also seeks to effect policy reforms and to engender medium- to long-term economic change. Minimally, the operating unit must: (i) analyze the primary causes of the economic problem (e.g., fiscal/monetary policies, exchange rates, inflationary pressures, major shifts in external economic relations, etc.); (ii) assess balance of payments and public sector fiscal accounts to estimate the impact the proposed assistance will have on the country's balance of payments and its net external financing requirements; (iii) undertake institutional and financial management analyses to ensure in-country capability exists to implement all elements of the assistance; e.g., policy reform, commodity imports, programming and accounting for HCOLC, etc. (These analyses shall be based on the operating unit's general assessment of the host country's accountability

environment, which assessment is required periodically by USAID/W; and (iv) in the event of using a CIP (see section 4.32), conduct a current market analysis to assess the demand and supply for the proposed commodities, as well as an analysis of implementation practices.

3.44 Implementation

The design of BPB support must include careful implementation planning so as to maximize success and ensure USAID's ability to meet the accountability requirements associated with this type of assistance. Minimally, the operating unit must develop mechanisms for: (i) frequent review of conditions and country performance where appropriate; (ii) tracking the use of dollars (if a cash disbursement is used), or the allocation of funds and safe arrival and end use of commodities (if a CIP is used); and (iii) programming, monitoring, reporting and verifying the use of HCOLC. (See Section 4 for additional elements and requirements.)

3.5 SPECIAL MANAGEMENT REQUIREMENTS

3.51 Reporting

Periodic reports, usually quarterly, are required on all aspects of the activity managed by the recipient government (conditionality, dollar or commodity tracking, HCOLC deposits, disbursements and uses, etc.). It is incumbent upon the operating unit to verify, at least annually, the accuracy of host government reports. In some cases, particularly under commodity import programs (CIPs), it might be necessary for the operating unit to develop and manage its own system for monitoring and reporting on the utilization of funds, commodity tracking, etc.

3.52 Performance Measurement

Operating units are expected to work collaboratively with the host country in planning and measuring the tangible results of BPB support. See Series 200, Chapter 203, Monitoring and Evaluating Performance, for guidelines on monitoring indicators and assessing impact.

4 COMMON ELEMENTS AND REQUIREMENTS

4.1 Ownership and Sustainability

USAID experience underlines the importance of planning strategically, through appropriate consultation and consensus building, to gain support for sustainable change from relevant host country constituencies. Building ownership, fostering inclusiveness and participation, using flexible and client responsive approaches, and understanding the impact and influence of the external setting are all related to successful sustainable development outcomes. A collaborative design process that integrates implementation considerations into policy content builds participation and increases sustainability. Collaborative design fosters consensus, and increases technical efficiency.

4.2 Conditionality

When the purpose of the program assistance is policy or institutional reform and medium- to long-term economic change, a performance-based design option is preferred. Within this context, the development of effective conditionality is a critical element of the planning process. Conditions can be quantitative or qualitative, but always must be specific and measurable in order to provide clear benchmarks for the disbursement of resources.

4.21 Ensuring Effectiveness

Effective conditionality is a function of four elements: (i) the quality of conditions, where the performance criteria are both necessary and sufficient to achieve the purpose of the assistance; (ii) the number of conditions, where the desired reform is focussed on a few key points or criteria; (iii) the phasing of assistance, where sufficient time is established between tranching disbursements to allow for an assessment of country performance against agreed-upon criteria; and (iv) the degree of commitment by the host government to the proposed reforms, where the USAID activity is supporting only what the government is willing to do.

4.22 Description of Conditions

Conditions shall be documented by the operating unit, including the rationale for their selection, their relationship to the strategic objective supported by the assistance, and the expected effects (short-, medium-, and long-term) of the proposed reforms on the assistance environment. Approved conditionality must be clearly stated in the Agreement signed with the host government.

- 4.23 Defining Conditions Incrementally
- When the disbursement of USAID funds is expected to occur over more than one year, planners may design conditions incrementally. In such instances, two kinds of conditionality are contemplated: (i) conditions which are specific, action-oriented and complete for that period for which funds are being obligated; and (ii) more general conditionality for future year funding which is sufficient over the life of the assistance to lead to achievement of measurable results. Such an approach allows for further refinement of future year actions as experience is gained implementing the proposed reform. As the time approaches for the obligation of funds for future year reforms, the next set of conditions must be transformed into specific actions to be taken over the period for which funds are being obligated and so stated in the obligating document with the government.

4.3 RESOURCE TRANSFER MECHANISMS

4.31 Choosing A Resource Transfer Mechanism

There are two basic ways to transfer resources when using this type of assistance: (i) commodity import programs (CIPs); or (ii) cash disbursements. When planning a program assistance activity, the operating unit shall select and justify which resource transfer mechanism it proposes to use. Various factors must be weighed when making this determination, as described below.

(a) Foreign Exchange System: at what degree of openness does the foreign exchange regime operate? If the host country's foreign exchange system is market determined and sufficiently transparent and accountable, the cash disbursement supports that system by allowing USAID resources to flow through it. On the other hand, a closed system, where the price of foreign exchange is badly distorted, suggests the use of the more controlled CIP mechanism where practicable.

(b) Financial Management: what is the recipient government's ability to budget, account for, and control its own budgetary resources? If these systems are seriously flawed, it is incumbent on USAID to manage its assistance resources outside of host country systems. These circumstances suggest a CIP mechanism, since in almost all instances, cash disbursements rely heavily on the host country's systems for managing assistance resources.

(c) Accountability: there are definite management and accountability implications associated with both mechanisms, which the USAID operating unit must consider when making a choice between CIPs and cash disbursements. In general, CIPs allow for closer tracking of resources; the cash disbursement instrument, however, does maintain USAID monitoring and audit rights and responsibilities.

(d) Purpose and Timing: how effective will each mechanism be in achieving the purpose of the assistance in a timely manner? For instance, if one of the USAID objectives is immediate budgetary support, a cash disbursement is indicated, although a CIP could be capable of generating the equivalent local currency resources over a longer time period. If the major economic imbalance being addressed is the lack of foreign exchange for use by private importers, a private sector CIP is indicated.

4.32 When Using A Commodity Import Program (CIP)

(a) Introduction

Under a CIP, the host country allocates the foreign exchange provided by USAID among its importers in the public and private sectors to finance the purchase of products and equipment through regular commercial trade channels. Based on public announcements in the United States, transactions are completed directly between suppliers (usually American) and cooperating country importers. Suppliers are paid with USAID funds after shipment, upon presentation of standard, primarily commercial documents. In most cases, importers are required to put up the local currency equivalent in value to the dollar cost of the transaction. This local currency is governed by the requirements set forth in section 4.4.

USAID does not normally participate directly in procuring commodities under a CIP. While there are restrictions on purchasing certain categories of commodities (see point c, below), USAID generally does not determine the specific items to be purchased, nor does it select the suppliers.

(b) Targeting Importers, Commodities, and End Users

Based on the objectives of the assistance activity, planners are permitted to target particular groups of importers (e.g., export-oriented, agricultural, industrial, etc.), although importers need not be defined any more specifically than belonging to the private or public sectors. Some CIPs permit both. Except as legislation may direct otherwise, USAID generally encourages the financing of commodity imports by the private sector.

Planners are also permitted to target specific types of commodities or end user groups under a CIP, if it has been determined that these targets will contribute to achieving the objectives of the assistance activity. A commodity target can be a narrow range of commodities for one sector, which is often the case in a sector program assistance activity, or a wide range of goods for several sectors of the economy. Emphasis can be placed on raw material, intermediate goods or finished products, or some combination thereof.

(c) Commodity Eligibility

The entire "USAID Commodity Eligibility Listing" (see Series 300, Chapter 312), or a portion thereof, is authorized for financing under a CIP. Ineligible items

are not authorized for financing unless specifically made eligible by the cognizant AA or his/her designee. Waiver provisions on commodity eligibility, as established in Chapter 312, apply. In addition, USAID reserves the right, upon review of a supplier's Application for Approval of Commodity Eligibility, to decline to finance any commodity when, in USAID's judgement, such financing would adversely affect USAID's program objectives or the foreign policy objectives of the United States.

(d) Procurement Transactions

Procurement transactions between suppliers and importers are governed by USAID Regulation 1 (22 CFR Section 201), a copy of which is included in Series 300, Chapter 307. If the CIP is for the private sector, the requirements set forth in section 201.23 of USAID Regulation 1 apply. In addition to establishing sound commercial practices, USAID Regulation 1 requires that suppliers maintain documentation providing evidence that: (i) the funds are used for intended purposes; and (ii) transactions conform to other statutory and regulatory requirements concerning commodity source and price, use of U.S. flag ocean vessels, and identification of the commodity as USAID-financed.

In the event the CIP is for the public sector, it is USAID's policy to apply the procurement procedures in sections 201.22 of USAID Regulation 1. For additional details on CIP transactions, see Series 300, Chapter 307.

4.33 When Using A Cash Disbursement

(a) Planned Uses Of Dollars

In most instances, the U.S. dollars provided by a cash disbursement are used for import and/or debt financing. When used for import financing, USAID policy allows those dollars to be disbursed through any of the following approaches: direct disbursement; reimbursement; or an auction. Decisions on how to transfer and use the U.S. dollars under a cash disbursement must be clearly documented. Both dollar use and accountability arrangements shall be tailored to suit the country's foreign exchange and import regimes, the integrity of its accounting system, and the political environment, as described in points (i-iv), below.

Under certain instances, cash disbursements are used to fulfill a U.S. government treaty obligation (e.g., an

ally which affords the United States base or access rights), or are granted to a developing country which has liberalized policies and institutions based on market-oriented principles. In these cases, simplified monitoring and accounting procedures are permitted (see point iv).

(i) Use of an auction or auction-like approach. The auction approach to disbursing dollars helps the recipient country move toward open market forces. This option makes sense where substantial liberalization of foreign exchange and import controls is underway or is at a relatively advanced stage of negotiation. An auction or auction-like system can be supported if: it permits the segregation of cash disbursement dollars in a separate account and provides for the trackability of USAID dollars to identifiable import transactions; the implementing authority can ensure USAID dollars are not used for ineligible items such as military, paramilitary or luxury imports; financing of U.S. import transactions approved at the auction are given first preference over other Free World transactions.

(ii) Finance imports directly or on a reimbursable basis. This option is more attractive than (i) above where imports, foreign exchange allocations, and presumably exchange rates are strictly controlled by authorities and where substantial liberalization is not anticipated. If this approach is used, then: priority shall be given to imports from the U.S.; dollar financing is restricted to items normally found eligible under USAID regulations, and as approved by the operating unit; and if appropriate, import approval and verification processes shall include a price-checking arrangement to assure that U.S. funds are not being used to effect capital flight through overinvoicing.

(iii) Debt servicing. In certain instances, it is permissible to use cash disbursement dollars to effect debt service payments. This is normally desirable where the recipient country's debt service is a significant barrier to growth and development, or where institutional arrangements preclude the traceable use of dollar disbursements to import transactions. Debt financing is particularly justifiable when such servicing will have a significant effect on leveraging additional flows of development resources. Debt service payments may be made directly to international

financial institutions (IFIs) bypassing the need for a separate dollar account.

As a matter of policy, it is not appropriate to use cash disbursement dollars to service categories of debt which are perceived as non-developmental in character. Therefore, debt servicing is subject to the following provisions:

- USAID dollars shall not be used to service loans or credits that originally financed military imports, unless determined otherwise by legislation or the Administrator;
- servicing current or recently contracted debt related to the purchase of non-military items legally prohibited from USAID financing (e.g., abortion equipment) is precluded;
- debt servicing must be consistent with the agreed restructuring arrangements and payments scheduling of the Paris and London Clubs, where applicable, and debt owed to the U.S. Government (exclusive of foreign military sales) shall have first priority;
- it is permissible to use cash disbursement dollars to service debt owed to multilateral development banks and the IMF, subject to prior concurrence of the appropriate regional AA;
- all other categories of debt financing contemplated by the USAID operating unit shall be approved on an exceptional case-by-case basis by the cognizant AA in consultation with PPC.

(iv) Relatively advanced ESF-recipient countries. In the case of relatively advanced ESF-recipient countries, USAID shall avoid any accountability procedures which would have the effect of reimposing foreign exchange or import controls. Simplified accountability and monitoring are also appropriate in those countries where USAID has no development presence. Procedures are to be determined on a case-by-case basis, permitting the segregation and tracking of dollars in the most simplified manner possible.

(b) Separate Accounts

Pursuant to law, and unless specifically exempted from this requirement, all cash disbursements of dollars made in connection with program assistance must be deposited into a separate account opened by the recipient country for this purpose. The number of the

separate account, the name of the bank, and the name of the owner of the account must be supplied to M/FM as early as possible prior to disbursement. Pursuant to law, cash disbursement dollars cannot be commingled with other host country funds in the separate account from the moment of deposit to the point of agreed-upon use.

A request to be exempted from the separate account requirement must first be approved by the cognizant operating bureau, and then submitted to Congress through the notification procedures of the Appropriations Committees. The main criterion for considering an exemption shall be the degree to which the separate account requirement interferes with the host country's foreign exchange allocation system.

(c) Dollar Tracking

Legislation requires that the use of funds deposited in the separate dollar account be trackable. In carrying out this requirement, the operating unit must: specify and document how the cash disbursement is to be used (per section a, above); include the approved dollar uses as a provision in the government-to-government Agreement or in associated implementation letters; provide in such Agreement appropriate audit and redeposit provisions so as to protect the Agency; and develop sufficient procedures for ensuring the cash disbursement is used only for approved purposes.

(d) Interest Earned on Special Dollar Account

USAID policy requires that interest earned on dollars in the separate account be avoided in specific ways or returned to the U.S. Treasury (see Supplemental Reference "Cash Transfers and Interest Earnings," dated 8/1/94, State 205189).

(e) Congressional Notifications (CNs) (See Supplementary Reference on CNs in Series 200, Chapter 202, Managing for Results: Achieving)

USAID is required by legislation to submit a Congressional Notification at least fifteen (15) days prior to the obligation of any cash disbursement assistance. The CN must: (i) describe the planned uses of dollar disbursements; discuss the U.S. interests that will be served by the assistance; and (iii) as appropriate, describe the economic policy reforms that will be promoted by the assistance.

4.34 Other Cases

From time to time, USAID has the flexibility to choose another type of mechanism for the generalized resource transfer, such as a housing guarantee loan. In those instances, this choice must be fully justified and submitted to the standards for guaranties, as well as the requirements in this section.

4.4 LOCAL CURRENCY REQUIREMENTS

4.41 Host Country-Owned Local Currency (HCOLC)

When a generalized resource transfer results in a tangible flow (generation) of local currency to the host government, or when the assistance agreement requires the host government to set aside local currency, that local currency is considered to be owned by the host country (HCOLC) and it must be deposited into a separate account. In those instances, the HCOLC must be programmed jointly with USAID and in a manner consistent with applicable foreign assistance appropriations legislation (see section 3.1).

Where permitted by host country law or regulation, local currency separate accounts shall be interest bearing, and interest earned shall be similarly programmed jointly with USAID.

All transactions with the country's private sector (e.g., private sector imports under a CIP) must result in a tangible flow of local currency resources back to the host government, and be treated as described above.

Local currency need not be "generated" or deposited in a separate account when the transactions under the activity do not result in a tangible flow of local currency to the host government. This occurs, for example, when dollars are used to service external public sector debt or when commodities are imported by, and for the use of, the recipient government. In these instances, operating units still have the option to require the host government to set aside an agreed-upon amount of local currency as a condition of the assistance. If operating units choose this option, they must ensure that the budgetary resources are available to be set aside, or the government may be forced to reduce important expenditures, increase taxes or borrowing, and/or print money.

4.42 Approved Uses of HCOLC

The four options for programming HCOLC are: (i) investing directly in developmentally sound activities;

(ii) supporting particular sectors of the government's budget; (iii) funding the government's deficit or reducing the government's domestic debt; and (iv) funding administrative costs of the U.S. government. The first option includes discrete activities contained in the host country budget, activities implemented by non-government organizations (NGOs), as well as the host government's contribution to USAID, other donor, or international financial institution (IFI) activities.

4.43 HCOLC Implementation Requirements

(a) Accountability: Current legislation requires that USAID carry increased responsibility for the accountability of local currency "generated" by a USAID-financed activity. When using such local currency generations, USAID shall ensure that: (i) HCOLC is deposited and disbursed in the agreed-upon manner; (ii) local currencies are used for intended purposes once they are disbursed from the special account; and (iii) the impact of the HCOLC-financed programs is evaluated.

(b) Monitoring: Monitoring and verification requirements increase as local currency is programmed for more specific uses. For example, programming HCOLC for individual development activities will require more operating unit monitoring than programming local currency for general budget support. The operating unit has the option to supplement its monitoring resources by contracting for technical assistance with program funds.

(c) Audits: Operating units must ensure that recipient government audits of separate accounts are performed at least once a year. These recipient audits are to be recipient-contracted, USAID-contracted, or performed by the host government supreme audit institution (SAI). Such audits shall include a funds accountability statement covering the program and the organization as a whole, internal controls, and a review of compliance with the terms of the agreement, with separate opinions provided for each element of the audit. Local currency associated with a given program is the preferable source of funding for such audits.

4.5 DOCUMENTATION REQUIREMENTS

All of the key elements of program assistance (e.g. conditionality, resource tracking, HCOLC programming and accountability, etc.) must be documented. The

operating unit must document the rationale for selecting this type of assistance and choosing the resource transfer mechanism it intends to use.

4.6 OBLIGATION OF RESOURCES

The standard provisions for program assistance agreements will depend on whether a CIP or cash disbursement is being used. (See Series 300, Acquisition and Assistance Agreements, for the appropriate agreement format.)

In instances where HCOLC is made available, the program assistance agreement must specify the total amount of dollars which will "generate" local currency, the exchange rate that will be used to express that amount in local currency, and provisions to change the HCOLC amount in the event there are major fluctuations in the host government exchange rate. The USAID exchange rate policy can be found in Supplemental References, 87 State 1860822. The agreement shall also stipulate when the local currency deposits will be made during the life of the assistance activity.

A separate agreement, following the standard provisions used in bilateral field activities, is required when traditional inputs are used in combination with a generalized resource transfer, as is frequently the case in sector program assistance activities. (See Series 300 for the appropriate format.)

4.7 SUPPLEMENTARY REFERENCES

See USAID Policy Paper: Approaches to the Policy Dialogue, December 1982 (PN-AAM-431).

"The Role of Resource Transfers in U.S. Economic Assistance," dated 7/9/82, State 189715.

"ESF Cash Transfer Assistance - Amplified Policy Guidance," dated 10/20/87, State 325792.

"USAID Exchange Rate Policy Guidance," dated 6/17/87, State 1860822.

Financial Management Guidance on Dollar Separate Accounts for ESF Cash Transfers and ESF-, DA-, and DFA-funded NPA Cash Disbursements, dated June 1990, State 194322.

Policy Determination #18, dated 7/31/91, Local Currency (PN-AAV-467).

USAID's Supplemental Guidance on Programming and Managing Host Country-Owned Local Currency, dated 6/21/91, State 204855.

FM/C, Memorandum, dated 7/30/91, Part II, Bulletin No.5 - Local Currency Trust Funds -72FT800 (Host Country Owned Funds).

Handbook 19, Financial Management for financial procedures related to CIPs and Cash Transfers: Chapters 1F; 2H; 6C and 6E; 8A and 8B; 10K and 10N.

"Cash Transfers and Interest Earnings," dated 8/1/94, State 205189.

Clearances:

Clearances:

PPC/LDP:MCrosswell_____date_____
AFR/DP:JGovan_no obj.date 9/5/95
ANE/DP:FYoung_no obj.date 9/5/95
BHR/PPE:FNelson(e-mail)date 8/25/95
ENI/PCS:JOnly_no obj.date 9/5/95
FM/PPC:RHammwesley(e-mail)date 9/14/95
G/PDSP:TMahoney:_no obj.date 9/5/95
GC:BLester_(e-mail)_date 02/13/96
IG/A/HLC:WTeebo(e-mail)date 9/1/95
LAC/DPP:BBurke(e-mail)date 9/7/95
AA/LPA:VYoung_no obj.date 9/5/95
M/FM/PPC:RLevine_no obj.date 9/5/95
M/MPI/OD:BBurnett(draft)date 8/29/95
M/OP/POL:JLewis(draft)date 8/28/95
AA/PPC:JBallantyne_____date_____
AA/PPC:CBradford_____date_____
M/AS/ISS:GPettigrew_____date_____

PPC/ECON:RGreene:rjg:x7-8573:2/14/96:npamkup.fnl